IMPACT OF GOVERNMENT DOMESTIC BONDS ON CAPITAL MARKET GROWTH IN NIGERIA

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ABSTRACT
The Nigerian capital market plays a pivotal role in fostering economic development by mobilizing long-term funds and channeling them into productive investments. As a financial intermediary, it facilitates the flow of resources from surplus units (investors) to deficit units (borrowers), thereby promoting savings, investment, and wealth creation. This study investigates the effect of sovereign government domestic bonds (Federal Government of Nigeria Bonds [FGN Bonds], FGN Savings Bonds, and FGN Sukuk) on the growth of the Nigerian capital market from 2009 to 2024. Using an ex post facto research design, quarterly time-series data were analyzed through the Autoregressive Distributed Lag (ARDL) model to estimate both short-run and long-run relationships. The findings reveal that FGN Bonds, FGN Savings Bonds and FGN Sukuk significantly affect the positive long-term effects on the growth of the Nigerian capital market. The study concludes that sovereign bonds play a critical role in driving the growth and development of the Nigerian capital market, underlining the need for strategic policies to ensure sustainable market expansion. Based on these results, the study recommends strategies to optimize bond issuance, such as addressing short-term disruptions, intensifying awareness campaigns for FGN Savings Bonds and encouraging greater issuance of FGN Sukuk.

Keywords*:* Capital Market growth, Federal Government Bonds, Savings Bonds, Sukuk
JEL Codes: E50, F31, E44, C32

1. INTRODUCTION
The capital market serves as a vital engine for economic growth by facilitating the mobilization and allocation of long-term funds to productive sectors. In emerging economies like Nigeria, the capital market comprises the Nigerian Exchange Group (NGX), the FMDQ Securities Exchange, and the Securities and Exchange Commission (SEC), which together oversee activities in equities, corporate bonds, and government securities. Among the instruments utilized in Nigeria's financial system, government domestic bonds such as Federal Government of Nigeria (FGN) Bonds, Treasury Bills, and Sukuk have become a prominent tool for financing fiscal deficits, infrastructure development, and public investment projects. These instruments are typically issued by the Debt Management Office (DMO) and traded on the FMDQ and NGX platforms, providing both

investment opportunities for individuals and institutions and a mechanism for government debt management (Okafor & Emenike, 2023).

However, Nigeria's capital market exhibits several unique characteristics that distinguish it from those of more developed economies. It remains relatively shallow, with limited product diversification and a high concentration of retail investors (SEC Nigeria, 2022; Adegbite & Ayoola, 2023). The market also suffers from low liquidity, weak investor confidence, and regulatory inefficiencies, often attributed to governance issues, macroeconomic instability, and inconsistent policy implementation (CBN, 2023; Okonkwo et al., 2024). Furthermore, the dominance of government domestic bonds particularly Federal Government Bonds and Treasury Bills introduces a distortion in the investment landscape. Due to their low-risk and fixed-income nature, these instruments tend to attract a large share of institutional and retail capital that might otherwise have been directed toward higher-risk, growth-enhancing instruments such as equities and corporate bonds (Wahidin et al., 2021; DMO Nigeria, 2023). This situation raises important questions about the dynamic relationship between government borrowing through domestic bonds and the broader development of the capital market in Nigeria, especially in light of efforts to diversify the economy and strengthen private sector investment.

Despite an increase in the issuance and subscription of government domestic bonds in recent years, the Nigerian capital market has not demonstrated commensurate growth in terms of market capitalization, turnover ratio, or foreign portfolio investment (DMO, 2023; NSE, 2023). While proponents argue that government bond issuances help deepen financial markets by introducing risk-free benchmarks and attracting a broader base of investors (Zhang et al., 2024; McMillan, 2021), critics contend that these instruments may crowd out private sector investment by diverting funds away from equities and corporate bonds, thereby stifling innovation and limiting capital market depth (Bajra & Wagner, 2024; Okonkwo et al., 2024).

Existing literature has extensively explored the relationship between bond markets and economic growth, yet there is a noticeable gap in studies focusing specifically on how government domestic bonds influence capital market growth, especially within the Nigerian context. For instance, Zhang et al. (2024) examined the role of local government debt in China's economic growth, focusing on general obligation and revenue bonds, but did not address capital market outcomes. Similarly, Wahidin et al. (2021) assessed bond market development and economic growth before and after the global financial crisis across various countries but offered limited insights into how bonds affect capital market structures in individual developing nations. McMillan (2021) analysed the predictive ability of stock and bond markets for U.S. economic growth, providing valuable insights for mature markets but lacking relevance for emerging ones like Nigeria. Moreover, recent studies by Zhao et al. (2022) and Bajra and Wagner (2024) concentrated on green bonds and their environmental and economic impact, thereby narrowing their focus to sustainable finance rather than traditional government securities.

These studies collectively underline a significant evidence gap. Despite the relevance of bond markets in a broader economic discourse, there is insufficient empirical research investigating the effect of government domestic bonds (FGN Bonds, FGN Savings Bonds, and FGN Sukuk) on capital market growth in Nigeria. It is against this backdrop that this study attempts to examine the effect of sovereign domestic bonds on capital market growth in Nigeria.

2. LITERATURE REVIEW

The relationship between government domestic bonds and capital market growth can be viewed from two perspectives. On one hand, government bonds may promote market development by providing a risk-free benchmark, enhancing liquidity in the debt segment, and attracting conservative institutional investors who may later diversify into riskier assets. On the other hand, excessive issuance of government bonds could potentially crowd out private sector investment, reduce demand for corporate securities, and constrain equity market expansion (Zhang, 2023; Ghouma & Ouni, 2022).

Empirical Studies

Numerous empirical studies have examined the relationship between bond markets—particularly sovereign bonds, Sukuk, and other fixed-income instruments—and capital market performance or economic development. For instance, Dong et al. (2023), using a comparative global analysis, found that green bonds are more effective than conventional bonds in hedging stock market risks. In a similar vein, Ejaz et al. (2022) employed multivariate econometric models to show that green bonds offer diversification benefits and reduced risk exposure in international portfolios. Chang and Li (2024), using a stochastic volatility model in China, concluded that capital market volatility significantly affects economic growth, reinforcing the need for stability in financial instruments such as bonds.

Focusing on Nigeria, Omodero (2024) utilized regression analysis and found that the issuance of state bonds can negatively impact private sector growth, largely due to crowding-out effects. Complementing this, Omodero and Alege (2021) applied descriptive and inferential statistics to demonstrate that while government bonds contribute to the expansion of Nigeria's capital market, they can also stifle private investment if not well managed. Chidi-Okeke and Ubah (2023) used time series regression to empirically verify that Nigeria's bond market significantly enhances capital market performance, while Balogun and Talabi (2024) employed the ARDL model to confirm that bond market development is a strong driver of economic growth in the country. Likewise, Chidi-Okeke et al. (2020) found that the bond market facilitates economic development through capital formation.

In relation to Islamic finance instruments, especially Sukuk, a substantial body of literature highlights their developmental potential. Abubakar and Baba (2020) conducted a theoretical analysis and concluded that Sukuk financing supports national infrastructure and broader economic goals. Ahmed (2024), through a descriptive case study, argued that green Sukuk offers a sustainable solution to Nigeria's persistent electricity infrastructure challenges. Similarly, Sani et al. (2022) and Salaudeen (2021) both emphasized through qualitative and descriptive evaluations, respectively, that Sukuk is a viable and strategic tool for infrastructure financing. Ibrahim and Mustapha (2020) further affirmed through case study evidence that Sukuk is well-suited for petroleum infrastructure projects.

The social and behavioral dimensions of Sukuk have also been explored. Adelopo et al. (2023), using a mixed-methods approach, observed that religious sentiment significantly influences public perception and financial accountability in Sukuk investments. Theoretical contributions from Abdulkareem et al. (2021) suggested that Sukuk could be a remedy for Nigeria's problem of abandoned public projects. Similarly, Usman and Sa'ad (2023) provided a case-based analysis showing that Sukuk played a vital role in financing infrastructure during the COVID-19 pandemic. Oyesanya and Fa-Yusuf (2024), using quantitative regression, confirmed the positive impact of Sukuk on Nigeria's economic development.

On broader capital market dynamics, Omodero et al. (2023) showed that sovereign bonds significantly influence stock market returns in a rising economy like Nigeria. A cross-country panel data analysis by Nneka et al. (2025) supported the view that bond market development fosters economic growth across developing nations. At the global level, Pradhan et al. (2020) employed panel VECM to demonstrate that the development of stock and bond markets is a crucial factor in economic advancement among G-20 countries. In the U.S. context, McMillan (2021) used time series econometrics to show that stock and bond markets can forecast economic growth under certain conditions.

Within Nigeria's financial system, Aliyu et al. (2024) used multiple regression techniques to find that the capital market plays a significant role in supporting economic growth. Ogungbenle and Ogungbenle (2020), through a simulation of Svensson's model, revealed how Eurobond structures affect investor risk perception. Lawal et al. (2025) applied monetary and sentiment regression to show how investor behavior and money supply influence stock returns. Olawale et al. (2023) used VECM analysis to demonstrate that external financial flows significantly affect the Nigerian capital market's All-Share Index. Finally, Ikeobi (2020) found through regression analysis that capital market development positively influences the output of quoted manufacturing firms in Nigeria.

Theoretical Literature

Liquidity Preference Theory

The Liquidity Preference Theory, formulated by Keynes (1936), posits that investors prefer holding liquid and low-risk assets, especially during periods of economic uncertainty. In Nigeria, the high uptake of government domestic bonds reflects this preference, as these instruments offer relative safety amid macroeconomic instability, exchange rate volatility, and inflation (Omodero & Alege, 2021; Omodero, 2024). FGN Bonds and Sukuk provide liquidity through secondary market trading and serve as low-risk alternatives for investors seeking to preserve capital. This aligns with findings by Liu et al. (2022), who noted that sovereign bonds often function as safe havens in emerging markets. However, an overemphasis on government securities may crowd out private investments and limit capital market depth (Chidi-Okeke & Ubah, 2023).

Financial Deepening Theory

The Financial Deepening Theory by McKinnon and Shaw (1973) argues that the expansion and diversification of financial markets enhance savings mobilization, investment efficiency, and economic growth. In Nigeria, sovereign bonds have helped promote financial deepening by introducing new instruments such as FGN Savings Bonds, which attract retail investors, and FGN Sukuk, which accommodate faith-based investing (Abubakar & Baba, 2020; Sani et al., 2022). These instruments broaden access to the capital market and improve inclusiveness. Empirical studies by Balogun and Talabi (2024) and Chidi-Okeke et al. (2020) further support the notion that bond market development positively contributes to capital market performance and overall financial sector growth.

Modern Portfolio Theory

Markowitz's (1952) Modern Portfolio Theory emphasizes the importance of diversifying investments to minimize risk and optimize returns. In the Nigerian capital market—characterized by volatility and limited financial instruments—sovereign bonds serve as critical tools for portfolio diversification. Their relatively stable returns appeal to institutional investors such as pension

funds and insurance companies (Dong et al., 2023). The inclusion of green bonds and Sukuk further strengthens portfolio options, enabling alignment with ESG and faith-based mandates (Ejaz et al., 2022; Ahmed, 2024). According to Omodero et al. (2023), the performance of sovereign bonds in Nigeria has helped stabilize investment returns, thereby improving investor confidence and deepening the market.

3 METHODOLOGY

3.1 Theoretical Framework

This study is underpinned by the Liquidity Preference Theory, which posits that investors prefer liquidity and will demand a premium for holding less liquid assets (Keynes, 1936). In the context of Nigeria's capital market, this theory explains investor behavior in response to sovereign debt instruments like FGN Bonds, FGN Savings Bonds, and FGN Sukuk.

3.2 Model Specification

The empirical model adopts the Autoregressive Distributed Lag (ARDL) framework due to the mixed order of integration I(0) and I(1)) in the time series data and its suitability for small sample sizes. The model evaluates the short-run and long-run relationships between market performance and various forms of government securities issued in Nigeria. The model is specified as follows:

$$\Delta ASI_t = \alpha_0 + \sum_{i=1}^{p} \beta_i \Delta ASI_{t-i} + \sum_{j=0}^{q_1} \theta_j \Delta FGNB_{t-j} + \sum_{k=0}^{q_2} \phi_k \Delta FGNSB_{t-k} + \sum_{l=0}^{q_3} \delta_l \Delta FGNSK_{t-l} + \lambda_1 ASI_{t-1} + \lambda_2 FGNB_{t-1} + \lambda_3 FGNSB_{t-1} + \lambda_4 FGNSK_{t-1} + \varepsilon_t$$

The study utilizes quarterly time series secondary data from reliable and authoritative sources. Data on capital market performance are collected from the Nigerian Exchange Limited (NGX) and Central Bank of Nigeria (CBN) statistical bulletins period 2009 to 2024

Table 1 Measurements of variables

Variables	Measurement	Sources
Capital Market Growth (CMG)	The All Share Index (ASI) is used as a proxy for measuring the growth and performance of the Nigerian capital market. It reflects the aggregate value of all listed equities on the NGX,	Momoh (2020)
FGN Bonds	Annual issuance value (in Naira) of Federal Government of Nigeria Bonds	Afolabi & Olagunju (2019), Osazee & Momoh (2020)
FGN Savings Bonds	Value of Federal Government Savings Bonds issued annually	Onuoha et al. (2018), Osazee &
FGN Sukuk	Value of Federal Government Sukuk issued annually	Mouhammed (2020), Afolabi & Olagunju (2019)

4. RESULTS AND DISCUSSION

Table 2: Unit Root Test

Variable	t-Statistic	p-Value	Stationarity
ASI	-3.86902	0.0118	Stationary at first difference (I(1)) – Reject null hypothesis at 5% significance level.
FGN Bonds	-4.3191	0.0064	Stationary at second difference (I(2)) – Reject null hypothesis at 1% significance level.
FGN Savings Bonds	-5.96318	0.0004	Stationary at level (I(0)) – Reject null hypothesis at 1% significance level.
FGN Sukuk	-3.17192	0.0458	Stationary at first difference (I(1)) – Reject null hypothesis at 5% significance level.

E-View output 2024

The unit root test results provide critical insights into the stationarity properties of the variables used in this study. For the All Share Index (ASI), the null hypothesis of a unit root was rejected at the 5% significance level, with a t-statistic of -3.869019 and a p-value of 0.0118. This indicates that the ASI is stationary at the first difference I (1)), meaning it becomes stable after taking the first difference. For FGN Bonds (LFGNB), the results reveal that the series is integrated of order 2 I(2)). The null hypothesis of a unit root was strongly rejected at the 1% significance level, as evidenced by the t-statistic of -4.319104 and a p-value of 0.0064. This implies that the log-transformed FGN Bonds require two differences to achieve stationarity.

In the case of FGN Savings Bonds (LFGSB), the results indicate that the series is already stationary at the level I(0)). With a highly significant t-statistic of -5.963183 and a p-value of 0.0004, the null hypothesis of a unit root was strongly rejected at the 1% significance level. This suggests that no differencing is required for this variable, making it suitable for inclusion in econometric models without transformation. Finally, for FGN Sukuk (LFGNSK), the null hypothesis of a unit root was rejected at the 5% significance level, with a t-statistic of -3.171922 and a p-value of 0.0458. This confirms that the log-transformed FGN Sukuk is stationary at the first difference I(1)), requiring only one difference to achieve stationarity. This mixed integration order supports the use of the ARDL bounds testing approach, which is robust to variables with different orders of integration.

Table 3: Cointegration Rank Test
Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.333101	51.51076	47.85613	0.0218
At most 1	0.172857	20.31677	29.79707	0.4016
At most 2	0.070871	5.703903	15.49471	0.7302
At most 3	0.000569	0.043827	3.841465	0.8341

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.333101	31.19399	27.58434	0.0164
At most 1	0.172857	14.61287	21.13162	0.3169
At most 2	0.070871	5.660076	14.26460	0.6571
At most 3	0.000569	0.043827	3.841465	0.8341

The results of both the Trace and Maximum Eigenvalue tests suggest that one cointegrating equation exists among the variables in the model. This implies that there is a long-run equilibrium relationship among the variables studied. This finding justifies proceeding to Vector Error Correction Model (VECM) to capture both the short-run dynamics and long-run equilibrium adjustments.

Table 4: Long-run Cointegrating Equation (CointEq1)

Variable	Coefficient	Std. Error	t-Statistic	Interpretation
FGNB(-1)	-6.38E+10	9.10E+09	-7.03	Significant long-run negative effect
FGNSB(-1)	-1074.135	240.411	-4.47	Significant long-run negative effect
FGNSK(-1)	3.35E+08	5.20E+08	0.64	Not significant
Constant (C)	6.06E+11	-	-	Intercept term

In the long-run cointegrating equation (CointEq1), FGNB(-1) has a statistically significant negative coefficient, indicating that Federal Government of Nigeria Bonds have a long-run negative effect on capital market growth. Similarly, FGNSB(-1) (Federal Government of Nigeria Savings Bonds) also shows a significant negative long-run relationship. However, FGNSK(-1) (Federal Government of Nigeria Sukuk) has an insignificant coefficient, suggesting no meaningful long-run impact on capital market growth.

Table 4:. Error Correction Terms (Adjustment Speeds)

Dependent Variable	Error Correction Term (CointEq1)	Std. Error	t-Statistic	Interpretation
D(CMG)	-0.06044	0.06576	-0.919	Not significant; slow adjustment
D(FGNB)	-3.72E-12	1.10E-12	-3.38	Significant adjustment toward equilibrium
D(FGNSB)	0.000422	8.60E-05	4.89	Significant and fast adjustment
D(FGNSB)	0.000422	8.60E-05	4.89	Significant and fast adjustment
D(FGNSK)	9.30E-12	1.20E-11	0.79	Not significant

The error correction term for CMG (-0.060442, t = -0.919) is negative but not significant, indicating a weak and slow adjustment to long-run disequilibrium. FGN Bonds show a significant negative adjustment (-3.72E-12, t = -3.38), suggesting a strong corrective role. FGN Savings Bonds, though significant (0.000422, t = 4.89), have a positive coefficient, implying divergence from equilibrium—possibly due to short-term investor behavior. FGN Sukuk (9.30E-12, t = 0.79) shows no significant adjustment, indicating a minimal role in equilibrium correction.

Table 5: ARDL

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
ASI(-1)	0.793230	0.112466	7.053048	0.0000
FGNB	-0.175834	0.058956	-2.982438	0.0065
FGNB(-1)	0.344815	0.098465	3.501920	0.0018
FGNSB	4.63E-09	1.18E-09	3.925940	0.0006
FGNSB(-1)	-3.30E-09	1.26E-09	-2.611755	0.0153
FGNSK	-0.012357	0.004552	-2.714783	0.0121
FGNSK(-1)	0.015176	0.004852	3.127653	0.0046
C	-1.008687	1.082920	-0.931451	0.3609
R-squared	0.909322	Mean dependent var		4.457379
Adjusted R-squared	0.795975	S.D. dependent var		0.123253
S.E. of regression	0.055672	Akaike info criterion		-2.640670
Sum squared resid	0.074386	Schwarz criterion		-1.509264
Log likelihood	103.6184	Hannan-Quinn criter.		-2.203146
F-statistic	8.022456	Durbin-Watson stat		2.147839
Prob(F-statistic)	0.000001			

Ramsey RESET Test

Test Statistic	Value	Degrees of Freedom (df)	Probability (p-value)
t-statistic	0.1891	71	0.2344
F-statistic	0.9263	(1, 71)	0.1335
Likelihood Ratio	25.4013	1	0

The Ramsey RESET test indicates no evidence of model misspecification. Both the t-statistic (0.1891, p = 0.2344) and F-statistic (0.9263, p = 0.1335) are insignificant, suggesting the model is correctly specified sovereign government domestic bonds on the development of the Nigerian capital market. The R-squared value of 0.909322 suggests that around 90.93% of the variation in the All Share Index (ASI) can be accounted for by the independent variables in the model, which include FGN Bonds, FGN Savings Bonds, FGN Sukuk, and their lagged values. The F-statistic shows a p-value of 0.000001, indicating a high level of significance. This enables the rejection of the null hypothesis at all standard significance levels (such as 1%, 5%, or 10%). This indicates that the model overall demonstrates statistical significance and successfully reflects the relationship between the dependent variable and the independent variables.

The ARDL model reveals that the Nigerian capital market (proxied by the All Share Index) is significantly influenced by sovereign bond instruments both in the short run and long run. The coefficient of **ASI(-1)** is 0.793 ($p < 0.01$), indicating strong market persistence. Economically, this means that **approximately 79% of past market performance carries over to the present**, reflecting investor behavior based on trend-following and reinforcing market inertia. This persistence suggests that policy shocks or interventions may take time to materialize fully in market adjustments. . This aligns with Modern Portfolio Theory, which suggests that investors make decisions based on historical returns, and is empirically supported by Osamwonyi and Kasimu (2013) and Olawale et al. (2023), who found persistence in Nigeria's capital market behavior.

The contemporaneous coefficient of FGNB (-0.1758) implies that a one-unit increase in the issuance of FGN Bonds is associated with a 17.6% immediate decline in market performance, holding other variables constant. This reveals that in the short run, FGNB competes with equities for investor funds, potentially crowding out capital market investment. However, the positive lagged coefficient of FGNB (0.3448) indicates that in the long run, these bonds help stabilize and deepen the market. In practical terms, this means that over time, FGNB contributes about 34% to market growth, likely due to improved confidence and investment diversification.

For FGN Savings Bonds (FGNSB), the coefficient of 4.63E-09 (short-run) may seem numerically small, but considering the large-scale volume of government bond issuances and aggregate market indices, even marginal effects can represent substantial absolute changes in market value. Conversely, the negative lag (-3.30E-09) suggests that these instruments boost the market initially by attracting retail investors but may reduce long-term equity flows, particularly if investors prefer

guaranteed returns over equity risk. This nuance highlights the need for balanced financial instrument design.

FGN Savings Bonds (FGNSB) display a significant positive short-term effect (β = 4.63E-09, $p <$ 0This behavior resonates with the findings of Okonkwo and Okezie (2016) and Balogun & Talabi (2024), who emphasized the transitory nature of such retail-driven bond investments.

With FGN Sukuk (FGNSK), the immediate negative effect (β = -0.0123) implies a 1.23% short-run reduction in market performance, as funds shift into Islamic bonds. However, the positive lagged effect (β = 0.0152) implies a 1.5% contribution to market performance over time, reflecting Sukuk's role in infrastructure investment and ethical finance integration. This reflects the principles of Financial Deepening and Islamic financial inclusion, as supported by Abubakar and Baba (2020), Sani et al. (2022), and Usman and Sa'ad (2023), who emphasized Sukuk's role in promoting infrastructure financing and economic growth in Nigeria.

5. CONCLUSION

This study investigated the dynamic effects of Federal Government of Nigeria (FGN) securities comprising FGN Bonds, FGN Savings Bonds, and FGN Sukuk—on the Nigerian capital market, using the All Share Index (ASI) as a proxy for market performance. Grounded in Liquidity Preference Theory, the findings reveal both short-run and long-run impacts of these instruments on the capital market. In the short run, certain government securities (FGN Bonds and Sukuk) initially divert investor funds away from equities due to their lower risk and higher liquidity. However, in the long run, these instruments contribute significantly to capital market development by increasing liquidity, attracting diverse investors, and enhancing market efficiency, as shown by the positive and significant lagged effects in the ARDL model.

5.1 POLICY RECOMMENDATIONS

The federal government should continue to issue a variety of bonds (green bonds, infrastructure bonds) to cater to a broader investor base and deepen market liquidity.

Awareness campaigns should target retail investors to increase uptake of FGN Savings Bonds, which can enhance financial inclusion and stimulate retail-level participation in capital markets.

Government agencies, particularly the Debt Management Office (DMO) and Ministry of Finance, should engage in sustained public education campaigns to highlight the long-term benefits of Sukuk such as funding infrastructure and offering stable returns to encourage patient capital and reduce short-term divestment from equities.

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